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Dairy and Products

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Report Highlights:

Argentine dairy exports in 2004 are projected to drop somewhat as an expected reactivation in domestic consumption will more than offset a slight milk production increase. Dry whole milk powder, the most exported product, would suffer some reductions. Cheese and nonfat dry milk exports are expected to remain quite stable. Brazil, Algeria, Mexico and Chile are forecast to be the largest markets, taking 60 percent of the country's total dairy exports. Production for 2004 is projected to begin to recover, as returns at the farm level are good. However, with a strong dollar and good prices of grains and oilseeds, the recovery could be slow.

Includes PSD Changes: Yes
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SECTION I. SITUATION AND OUTLOOK

Argentine dairy exports for 2004 are projected to drop marginally from 2003 level. An expected recovery in domestic demand will more than offset slightly higher milk production, leaving somewhat shorter supplies for export.

Most traders believe that in 2004, whole dry milk will be practically the only product to suffer a reduction in exports. Shipments will be somewhat lower than those of 2003 and about half the volume of 2002. Most milk surplus from the domestic market is processed into whole dry milk, the most important export product, which is easily marketed throughout the world. In 2002 over 70 countries purchased Argentine dry whole milk powder (DWMP). Traders indicate that foreign markets, such as Mexico, are demanding more instant dry milk, which sells at \$30-40 per ton more than the regular product. Cheese is the second most important dairy product which is exported. Shipments for 2004 are forecast at 23,000 tons, practically unchanged from the previous year. Hard cheese, which accounts for 40 percent of total cheese exports, goes primarily to the U.S. Semi-soft cheeses account for a little less than half of cheese exports and are shipped primarily to Mexico, while soft cheeses account for the balance and are bought primarily by Brazil. Nonfat dry milk (NFDM) exports for 2004 are projected to remain unchanged at 12,000 tons, due to the shortage of milk.

The following table shows Argentine dairy exports by product from January/August 2003 (in metric tons):

Product	Volume	%	\$/MT
Dry Whole Milk	58,722	63.4	1,664
Cheese	11,690	12.6	2,228
Nonfat Dry Milk	8,930	9.6	1,422
Whey	5,527	6.0	616
Lactose Protein	3,050	3.3	2,110
Dulce de Leche	1,343	1.5	1,009
Lactose	1,185	1.3	615
Other	2,160	2.3	---

Source: Servicio Nacional de Sanidad Animal (SENASA)

Brazil is expected to continue to be the largest market in 2004, taking in roughly 20 percent of Argentine total dairy exports. During the 1990, the neighboring country accounted for 65-70 percent of exports. However, in 2001, Brazil filed an antidumping case on dry milk imports against several countries and set a minimum import price for Argentine product of \$1,900 per metric ton. This together with the strong devaluation of the Brazilian "real" in 1999 and its economic problems reduced significantly the importance of the Brazilian market. Algeria is also expected to be an important market for dry whole milk, especially with added vitamins and packages of half a kilo. Mexico and Chile are forecast to continue to be good markets for dry milk and cheese. The U.S., with its cheese tariff rate quota, will be a good market, but only for hard cheese.

The following table shows Argentine major export destinations for dairy products from January/August 2003:

Country	Volume (MT)	Total (\$1,000)	% Volume	Main Products
Brazil	19,133	27,580	21	DWMP, whey, NFDM
Algeria	17,173	29,994	18	DWMP
Mexico	9,930	14,985	11	DWMP, NFDM, cheese
Chile	8,299	13,997	9	DWMP, NFDM, cheese
U.S.	4,803	13,484	5	Cheese
Paraguay	3,604	6,990	4	DWMP

Source: SENASA

Most local traders predict good world dairy prices for 2004. Droughts in several major producing countries, the reduction of subsidies in the EU and a strong Euro (against the dollar) are all factors which are influencing trade in 2003 and are expected to do so for next year as well. Current local FOB price for dry whole milk powder is about \$1,800, a very good price compared to the average of the past several months. With current farmgate milk price at about \$0.16 per liter, exporters of dry milk are near to break even. Generally speaking, selling to the domestic market is better business than exporting, but the economy is recovering slowly and demand is expected to react at a similar pace.

Dairy imports for 2004 are projected to be insignificant, except for fluid milk. With the strong devaluation, retail prices of imported products have increased drastically. The combination of higher prices and a significant economic downturn have reduced Argentines' purchasing power. Special imported cheeses have practically disappeared from the shelves, although large supermarkets have expressed some interest in incorporating a few products but in small quantities. This is the case, for example, of U.S. cream cheese, which most supermarkets want to carry. Although very expensive, retailers want to attract higher income customers who consume these products.

The drop in milk output in Argentina forced a few local processors to find new sources of milk supply. Uruguay, very close to Argentina's main dairy area, became a good alternative for a few processors who needed to increase milk purchases. Imports for 2004 are projected at 30 million liters, similar to those of 2003. Uruguayan milk has to be exported pasteurized, and the price currently paid is slightly higher than local milk.

The following table shows current import duties, export rebates and export taxes for dairy products:

Product	Import Duty*	Export Tax	Export Rebate
Fluid Milk	13.5	5.0	3.4
Dry Milk Powder	17.5	5.0	3.4
Whey	15.5	5.0	4.05
Cheese	17.5	5.0	4.5

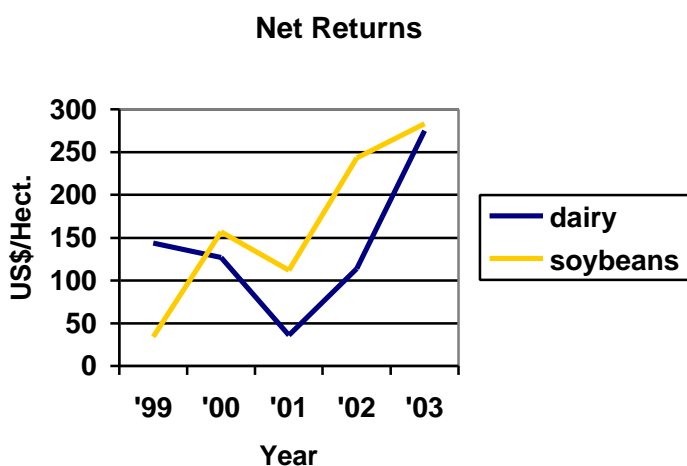
* duties among Mercosur members is zero

Milk production for 2004 is forecast at 8.1 million metric tons, a slight recovery from 2003. There is much talk about the production level for next year as there are some who expect output to be somewhat lower due to the persistent pressure of very profitable soybean production. Nevertheless, total output is projected to be quite similar to 2003.

The Argentine dairy sector expanded significantly in the 1990's, reaching its output record of 10.3 million tons in 1999. Since then, and through 2003, a number of economic crises in the country and region affected the sector severely. Milk output for 2003 is estimated at 7.9 million tons, down 23 percent since the record. The main factors for the drop in 2003 were the numerous dairies which either shut down or reduced their operations to shift to soybean production; the unfavorable condition of the dairy herd due to slim returns in 2001-02; and flooding in Santa Fe province in early 2003 and a very dry and cold winter in most of the milk producing areas.

Although there are no reliable data, sources indicate that during 1999-2003 some 25-30 percent of dairy operations were closed and the dairy cowherd dropped by 15-20 percent. The total number of dairy farms is currently estimated at 12-13,000 and the number of dairy cows is about 2 million. This process of shrinking is believed to have finished, as returns in the sector are now attractive.

The following chart shows the evolution of net results of good medium dairy and soybean operation in Argentina (costs taken in December of each year, except for 2003 which was October):



In the above chart one can clearly see two main points which have had a negative impact on the local dairy sector, and explain the significant reduction of milk production in the past years: 1) dairy returns. During the 1990's, dairy production was almost the best cattle and crop alternative. As shown in the chart, dairy returns in 1999 were four times higher than soybeans. From that year onwards, due to the large devaluation in Brazil, a severe economic recession and a strong, overvalued peso which discouraged exports, demand for milk dropped considerably. Farm gate prices weakened to an extent that many dairymen lost money (last semester of 2001). The strong devaluation in 2002 and economic crisis affected the dairy sector as feed prices and many inputs, tied to the dollar, increased almost in the same proportion as the devaluation. Farm gate milk prices caught up, but at a much slower pace. These months were dramatic for the dairy sector as the economy suffered sharp changes and there was a lot of uncertainty. Returns began to improve in mid-2002 as result of good exports and a recovery of the domestic market; 2) with the strong devaluation of 2002, returns of crops more than doubled in dollar terms. As Argentina is a strong exporter of grains and oilseeds, these are valued in dollars. Therefore, farmers' income almost tripled, while their costs increased but in a much smaller proportion. Many inputs are tied to the dollar, but overhead costs are in pesos and increased in a much smaller proportion.

The period 2001-2003, when soybean returns have been significantly higher than dairy, was when most dairy farms closed or reduced their operations significantly. In both cases, producers shifted to the much more profitable soybean production. The technology used in soybean production has improved significantly in the past few years. The use of roundup ready seed and no till seeding makes this a very low cost crop. Other factors that helped this significant shift were the lesser capital involved in cropping and the less amount of work demanded. Farm owners are currently being paid between 1.0-1.5 tons of soybeans to rent their land for production. This amount is somewhat less than what they would get if put into dairy production, but with no risk and little work.

As of June 2002, farm-gate milk prices have increased significantly, making dairy a very profitable business. With very good export returns and the adjustment of wholesale and retail prices, local processors to take advantage of their large capacity, began to buy more milk from producers, many of whom had shifted to supplying smaller companies. Since the devaluation, farm-gate milk prices have tripled in peso terms, while inflation in that same period was slightly over 40 percent. As shown in the chart, returns for both activities are now comparable. Therefore, the closing of dairies seems to be near its end and dairymen who survived the crisis will slowly increase their production. We can already see improved investment in genetics, nutrition and pastures. The key is to increase yield per cow and try to free up the maximum land for cropping. Dairy operations, which have made it through the crisis, are the most efficient ones and the cows left in production are the best as dairymen got rid of the less productive ones.

Farm-gate milk prices for 2004 are forecast to be similar to 2003. The first semester could be close to \$0.17 per liter and in the second semester, when the supply grows, prices will drop a few cents. Dairy production is once again a good business which has good potential growth. Milk production in the next few years should continue to recover moderately.

The local processing industry has been going through changes. With the crisis, small and medium regional processors have expanded, especially cheese manufacturers. The larger companies, which have lost milk volume and in some cases market share, blame it on the lack of control which encourages smaller processors to evade taxes and sanitary controls. Private sources indicate that the larger processors are currently using about half of their capacity. In the past several months there has been some investment in the sector. A couple of large companies have expanded their drying capacity, while another company has reopened an old plant of dry milk in Entre Rios province. Most small and medium processors have been expanding or improving parts of their plants. A good number of the larger local dairy companies invested heavily during the 1990 and therefore are burdened with sizeable debts with local and international creditors. Most of the companies are in the process of discussing payment terms, but several more months will go by until a solution is reached. Operational-wise, processors are profitable.

Based on private estimates, roughly 10 to 12 large processors account for 50 percent of the country's total dairy production and for almost all exports. About 100 medium cheese companies process roughly 25 percent of the total milk, and more than 1,000 small cheese manufacturers process the balance.

Saputo, a large Canadian dairy processor recently purchased Molfino-La Paulina dairy company, the third largest local processor. Both Saputo and Molfino are primarily cheese producers. Most sources indicate that local cheese exports could grow in the future taking advantage of Saputo's international position.

Domestic consumption of dairy products for 2004 is forecast to expand about 3-4 percent, similar to what most economists predict for Argentina's gross domestic product.

Approximately 40 percent of total dairy sales are through super and hypermarkets. Almost all large processors manufacture private labels for the large retailers. These products generally sell for 20-30 percent less than name brands.

The current retail price of a liter of milk is \$0.48, nonfat dry milk is \$2.71 per kilo, soft cheese \$3.15 per kilo, hard cheese is \$8.66 per kilo, and butter is \$4.40 per kilo.

Stocks in most products are projected to be low as result of a tight financial situation and practically no credit availability.

Since the new administration took office last May, the government has indicated that it will encourage domestic production and exports. The exchange rate, which nowadays is at 2.85 pesos to a dollar, is projected to remain about this level in 2004.

There is no specific official support to the domestic dairy sector. Production, marketing and trade are free. There are export rebates, but they are nullified by even higher export taxes.

The Argentine dairy sector in the past WTO Cancun meeting had a firm position of not reaching an agreement unless substantial advances were achieved. The sector was critical of the joint proposal U.S./EU, which they see as a drastic change from the previous position of the U.S. Argentina's position is to work hard on the elimination of subsidies, the limitation of domestic support, and the improvement of market access. However, the dairy sector's main focus is market access. While the sector waits for improvement in market access under the WTO, they continue to advance on regional agreements. The two most important are the FTAA and one with the EU. Sources indicate that an agreement with the EU is closer to being achieved. This agreement would include tariff rate quotas, and reduction of import duties in the long term. Under the FTAA, there are several countries which want the dairy sector to be excluded from the agreement or intend to include it on a list of extremely sensitive commodities.

SECTION II. STATISTICAL TABLES

Market Year Begin	Dairy, Commodity Milk, Fluid						(1000 HEAD)(1000 MT)	
	2002		2003		2004		Forecast	
	USDA Official [Old]	Revised Post Estimate [New]	USDA Official [Old]	Estimate Post Estimate [New]	USDA Official [Old]	Estimate Post Estimate [New]	USDA Official [Old]	Post Estimate [New]
		01/2002		01/2003				01/2004
Cows In Milk	2300	2150	2150	2000			0	2000
Cows Milk Production	8200	8500	7700	7900			0	8100
Other Milk Production	0	0	0	0			0	0
TOTAL Production	8200	8500	7700	7900			0	8100
Intra EC Imports	0	0	0	0			0	0
Other Imports	0	0	0	32			0	30
TOTAL Imports	0	0	0	32			0	30
TOTAL SUPPLY	8200	8500	7700	7932			0	8130
Intra EC Exports	0	0	0	0			0	0
Other Exports	10	10	8	1			0	1
TOTAL Exports	10	10	8	1			0	1
Fluid Use Dom. Consum.	2060	1990	2030	2000			0	2100
Factory Use Consum.	6130	6500	5662	5931			0	6029
Feed Use Dom. Consum.	0	0	0	0			0	0
TOTAL Dom. Consumption	8190	8490	7692	7931			0	8129
TOTAL DISTRIBUTION	8200	8500	7700	7932			0	8130
Calendar Yr. Imp. from U.S.	0	0	0	0			0	0
Calendar Yr. Exp. to U.S.	0	0	0	0			0	0

Country Argentina
Dairy,
Commodity Cheese

Market Year Begin	(1000 MT)					
	2002	Revised	2003	Estimate	2004	Forecast
	USDA Official	Post Estimate	USDA Official	Post Estimate	USDA Official	Post Estimate
	[Old]	[New]	[Old]	[New]	[Old]	[New]
	01/2002		01/2003		01/2004	
Beginning Stocks	34	34	33	29	26	27
Production	370	370	340	350	0	360
Intra EC Imports	0	0	0	0	0	0
Other Imports	1	1	1	1	0	1
TOTAL Imports	1	1	1	1	0	1
TOTAL SUPPLY	405	405	374	380	26	388
Intra EC Exports	0	0	0	0	0	0
Other Exports	22	26	18	23	0	23
TOTAL Exports	22	26	18	23	0	23
Human Dom. Consumption	350	350	330	330	0	345
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	350	350	330	330	0	345
TOTAL Use	372	376	348	353	0	368
Ending Stocks	33	29	26	27	0	20
TOTAL DISTRIBUTION	405	405	374	380	0	388
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	0	0	0	0	0	0

PSD Table

Country **Argentina**
Dairy, Dry
Whole
Milk

Commodity Powder

Market Year Begin	(1000 MT)					
	2002	Revised	2003	Estimate	2004	Forecast
	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]
		01/2002		01/2003		01/2004
Beginning Stocks	38	38	32	12	34	13
Production	180	205	170	165	0	165
Intra EC Imports	0	0	0	0	0	0
Other Imports	0	0	0	1	0	0
TOTAL Imports	0	0	0	1	0	0
TOTAL SUPPLY	218	243	202	178	34	178
Intra EC Exports	0	0	0	0	0	0
Other Exports	116	136	100	75	0	70
TOTAL Exports	116	136	100	75	0	70
Human Dom. Consumption	70	95	68	90	0	95
Other Use, Losses	0	0	0	0	0	0
Total Dom. Consumption	70	95	68	90	0	95
TOTAL Use	186	231	168	165	0	165
Ending Stocks	32	12	34	13	0	13
TOTAL DISTRIBUTION	218	243	202	178	0	178
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0
Calendar Yr. Exp. to U.S.	0	0	0	0	0	0

PSD Table

Country **Argentina**
Dairy,
Milk,
Nonfat

Commodity **Dry**

CommodityDry		(1000 MT)					
		2002 USDA Official [Old]	Revised Post Estimate [New]	2003 USDA Official [Old]	Estimate Post Estimate [New]	2004 USDA Official [Old]	Forecast Post Estimate [New]
Market Year Begin		01/2002		01/2003		01/2004	
Beginning Stocks	10	10	8	6	7	5	
Production	32	34	30	24	0	26	
Intra EC Imports	0	0	0	0	0	0	
Other Imports	0	0	0	1	0	0	
TOTAL Imports	0	0	0	1	0	0	
TOTAL SUPPLY	42	44	38	31	7	31	
Intra EC Exports	0	0	0	0	0	0	
Other Exports	20	22	18	12	0	12	
TOTAL Exports	20	22	18	12	0	12	
Human Dom. Consumption	14	16	13	14	0	15	
Other Use, Losses	0	0	0	0	0	0	
Total Dom. Consumption	14	16	13	14	0	15	
TOTAL Use	34	38	31	26	0	27	
Ending Stocks	8	6	7	5	0	4	
TOTAL DISTRIBUTION	42	44	38	31	0	31	
Calendar Yr. Imp. from U.S.	0	0	0	0	0	0	
Calendar Yr. Exp. to U.S.	0	0	0	0	0	0	